

TREASURY DEPARTMENT
UNITED STATES INTERNAL REVENUE

INCOME TAX PRIMER

(REVISED MARCH 1, 1919)

PREPARED BY THE BUREAU OF
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AND ASSISTANCE OF TAXPAYERS

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INCOME-TAX PRIMER.

(Revised March 1, 1919.)

RETURNS.

1. Am I required to render a personal income-tax return for 1918?

Yes; if unmarried, or if married and not living with husband or wife, and your net income for that year equals or exceeds \$1,000, or if you were married and living with husband or wife and your net income equals or exceeds \$2,000 for that year.

If you act as the guardian of a minor or incompetent person, or as the administrator, executor, or trustee of an estate or trust, a return will be required of you for and in behalf of your ward, or the estate or trust for which you act, if the conditions outlined under the head of "Fiduciaries," as requiring a return, are present in your case.

2. What is meant by the taxable year 1918?

The taxable year 1918 means the calendar year 1918 or any fiscal year ending during the calendar year 1918.

3. What does the term "fiscal year" mean?

The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December.

4. Upon what period of time shall my 1918 income-tax return be based?

Upon the calendar year 1918, except as stated in the next answer.

5. I have been computing my net income upon a calendar-year basis as required by the income-tax laws in force prior to the revenue act of 1918. May I change the basis of computing my net income to that of a fiscal year?

If you have actually been keeping your books on the basis of an accounting period of twelve months ending on the last day of any month in the year 1918 other than December, you may make a return for such accounting period. The return should be made in the same way as a return for the calendar year 1918, and should include your entire income for the accounting period of twelve months for which the return is made. An adjustment will be made for the income which was also included in the return for the calendar year 1917. If you have not been keeping your books on the basis of an accounting period ending in a month other than December, you must make your return for the calendar year 1918. The Revenue Act of 1918 and the Regulations provide a method for making a change in future years, but no change can be made with respect to the return for the year 1918.

6. Where should my personal return for the year 1918 be filed?

Section 227 (b) of the revenue act of 1918 provides that your return shall be filed with the collector of internal revenue for the district in which you have your legal residence or principal place of business. If your legal residence is located in one collection district and your principal place of business in another, it is optional with which collector your return shall be filed; but for administrative reasons the Commissioner of Internal Revenue desires that it be filed with the collector of the district in which your legal residence is located.

7. When may my 1918 return be filed with a collector of internal revenue?

If you make return on a calendar year basis, on any day after December 31, 1918, but not later than March 15, 1919.

8. Will failure to file my return within the time prescribed by law render me liable to any penalty?

Yes. Under the provisions of section 253 of the revenue act of 1918, you will be liable to a specific penalty of not more than \$1,000 if you fail to have your 1918 return in the office of the collector of internal revenue for your district before the close of business on March 15, 1919; and under the provisions of section 3176, Revised Statutes, you will be liable to 25 per cent additional tax. Therefore, you should use extreme care to see that your return is placed in the mails in ample time to reach the office of your collector before the close of business March 15, 1919.

9. May an extension of time beyond March 15, 1919, be obtained for the filing of my 1918 return?

Yes. If, on account of sickness or absence from home, you are unable to render your return within the time prescribed by law, you may obtain an extension of 30 days if a request therefor is filed with the collector of your district. In this request you must state the reason why the return can not be filed within the time prescribed by law.

10. Would a personal return rendered by an agent, for and in my behalf, be accepted?

If by reason of illness, absence, or nonresidence a taxpayer is unable personally to render his return he may appoint an agent to act for him and the return executed by the agent will be accepted if he makes affidavit that he has sufficient knowledge to make a complete and accurate return for his principal. Such agent assumes responsibility for making the return, and the penalties provided for a delinquent, erroneous, false, or fraudulent return are applicable to him.

11. What would happen should a taxpayer render a false or fraudulent return with intent to evade payment of a proper amount of income tax?

He would become liable, under the Revenue Act of 1918, to a fine of not to exceed \$10,000, or to one year's imprisonment, or both, in the discretion of the court, and to the costs of prosecution, and if he made an understatement of the tax which was false with intent to evade the tax, to a penalty of 50 per cent of the amount of the deficiency. If he willfully made a return which was false or fraudulent in other respects, he would, under section 3176 of the Revised Statutes, be liable to a penalty of 50 per cent of the amount of the entire tax.

12. May a husband and wife living together make separate returns?

Yes. They should in every case make separate returns where the wife has a separate income and the aggregate net income of both husband and wife is \$5,000 or over. Where the combined net income in excess of credits (see question 96) is in excess of \$4,000 separate returns must be made in order that there shall not be an overassessment of tax. Husband and wife living together are entitled to a personal exemption of not to exceed \$2,000 against their aggregate net income. If separate returns are made the personal exemption of \$2,000 may be taken by either or divided between them.

13. If a husband and wife make a joint return showing net income in excess of \$5,000, is the surtax upon that return based upon the aggregate amount of net income shown?

If a statement is attached to the return showing the amount of the wife's net income included in the return the surtax will be assessed only against the separate income of each in excess of \$5,000. But, as indicated in the answer to question 12, separate returns should be made where the net income of both husband and wife is in excess of \$5,000.

14. Is a married man who is entitled to a personal exemption of \$2,000 and \$400 additional exemption on account of two dependent children, and whose total net income does not exceed \$2,400, but does equal or exceed \$2,000, required to make a return?

Yes. Although he is not required to pay an income tax, he is required to make a return.

15. I act as agent for a nonresident alien individual. What responsibilities are imposed upon me by the income-tax law?

As the agent of a nonresident alien individual, you are responsible for correct returns of all income accruing to your principal within the purview of the agency, and for payment of any and all taxes assessed against that return.

16. Where can I get a blank form upon which to make my return.

From the collector of internal revenue of your district. The collector will endeavor to have such forms sent to you, but failure to receive one will not excuse you from making a return. If you do not receive one, it is your duty to request one of the collector.

EXEMPTION.**17. What amount of personal exemption is allowed by the revenue act of 1918?**

Section 216 (c) of the act allows a personal exemption of \$1,000, plus \$1,000 if the person making the return is the head of a family or a married man with a wife living with him. This additional exemption of \$1,000 is allowed if the person making the return is a married woman with a husband living with her, but in no event shall this additional \$1,000 be deducted by both husband and wife.

In addition a further exemption of \$200 is allowed for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer, if such dependent person is under 18 years of age or is incapable of self-support because mentally or physically defective. (Sec. 216 (b).)

EXEMPT INCOME.**18. What income, if any, is exempt?**

(a) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured;

(b) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

(c) The value of the property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income);

(d) Interest upon (1) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (2) securities issued under the provisions of the Federal farm-loan act of July 17, 1916; or (3) the obligations of the United States or its possessions, except as follows: In the case of obligations of the United States issued after September 1, 1917, the interest shall be exempt only if and to the extent provided in the respective acts authorizing the issue thereof as amended and supplemented and shall be excluded from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer;

(e) Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received, whether by suit or agreement, on account of such injuries or sickness.

(f) So much of the amount received during the present war by a person in the military or naval forces of the United States as salary or compensation in any form from the United States for active services in such forces as does not exceed \$3,500.

19. To what extent is interest received on Liberty bonds exempt from income tax?

(a) All interest received upon Liberty bonds is exempt from normal tax.

(b) In any event, interest upon the 3½ per cent Liberty bonds of the first series is exempt from both normal tax and surtax.

(c) In addition, a person is entitled to exemption from tax upon interest received on \$5,000 aggregate amount of bonds of later issues and war-savings certificates.

(d) If one originally subscribed for Liberty bonds of the fourth series he is also entitled to an exemption from tax on interest received upon bonds of the previous issues not to exceed one and one-half times the amount of the fourth Liberty bonds originally subscribed for and still owned, not to exceed in the aggregate \$45,000.

(e) The interest received on not exceeding \$30,000 principal amount of Liberty bonds into which first Liberty bonds may have been converted in the exercise of any privilege arising as a consequence of the issue of the fourth Liberty bonds is exempt.

(f) The interest received on not exceeding \$30,000 principal amount of Liberty bonds of the fourth issue is exempt.

The interest upon Liberty bonds, which is entirely exempt from income tax as defined above, should not be included in the gross income of the return, but should be reported in the return.

20. Are the salaries of State, county, and city officials and employees exempt from income tax?

Yes.

INCOME, NET AND GROSS.

21. What is meant by the term "Net income"?

Net income means your total gross income, not including income wholly exempt by law from the tax, less the general deductions allowed by law.

22. In rendering a return, what items of income must I report as gross income?

Under gross income should be reported every item of income derived from any source whatever (except those specified in the answer to questions 18 and 19 as wholly exempt) received during the taxable year for which the return is rendered, whether received in cash or the equivalent of cash, including:

(a) All amounts of salary, wages, commissions, or compensation of whatever kind received for personal service;

(b) All amounts of gain, profit, or income derived from any business or trade in which you are engaged or in which you have an interest and from any sale of property, real, personal, or mixed;

(c) Rents, interest on notes, mortgages, deeds of trust, or other securities issued by individuals, partnerships, etc., interest on bonds, mortgages, deeds of trust, or other similar obligations of corporations, joint-stock companies, associations, or insurance companies, and interest on bank deposits;

(d) All income received from fiduciaries, that is, all amounts received from incomes of estates, trusts, etc., through trustees, administrators, or executors, unless the taxes on such income was paid by the fiduciary prior to distribution;

(e) If you have an interest in a partnership you should report your distributive share of the earnings or profits of the partnership ascertained during the taxable year for which the return is rendered, whether distributed or not. If your net income for such taxable year is computed upon the basis of a period different from that upon the basis for which the net income of the partnership is computed, then your share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis on which your net income is computed is to be reported in your income-tax returns;

(f) All items of foreign income, including interest upon bonds and mortgages or deeds of trust or other similar obligations issued by individuals who are citizens or residents of foreign countries, foreign corporations, joint-stock companies, etc., and dividends from foreign corporations;

(g) Dividends on stock or from the net earnings of domestic corporations, joint-stock companies, associations, or insurance companies, whether paid in cash, stock, or scrip. As the net earnings of corporations, joint-stock companies, etc., are subject to the tax imposed upon the net income of corporations, dividends from such net earnings are not subject to the normal income tax in the hands of the shareholders receiving them, but they are to be returned for the surtax purposes, since they are subject to that tax. The rates of tax to be assessed against stock dividends received during the year 1918

or any subsequent year are covered by the answers to questions 44 to 51;

(h) If you own stock in a personal-service corporation, you should report your distributive share of the net income of such corporation for 1918 in the same manner as outlined in paragraph (e) above.

23. If my salary for December, 1918, is not paid to me until some day in January, 1919, or later, is its amount to be reported in my 1918 return?

No, unless as a matter of settled practice your books were kept on an accrual basis, in which event it should be returned by you for the year 1918, or unless credited and made available to you on December 31, although not actually drawn until later.

24. A is employed by a corporation at an annual salary of \$3,000. The corporation, being in financial straits, paid A only \$2,000 during each of the years 1916 and 1917. In 1918 A received his salary in full plus the balance of the salary due him for the two previous years. Must he include the full amount received in 1918 in his return for that year?

Yes. Five thousand dollars should be returned for 1918, and that amount will be subject to income tax at the rates prescribed for the year 1918, unless A kept his books of account on a basis other than that of actual cash receipts and disbursements, and unless the \$1,000 owing for each of the years 1916 and 1917 which was not received by A during those years was credited to him by the corporation and treated by him as income for those years in his returns.

25. If an employer agrees to pay an employee a certain stipulated salary and furnish him with room and board, are the latter items to be considered in computing income-tax liability?

Yes. A fair rental value is to be placed upon the room and a fair value upon the meals furnished, and these amounts reported as income by the employee.

26. An employee receives a per diem allowance for expenses in addition to his regular salary. Is this amount to be included as income in his return?

Yes. The entire amount of allowance received should be reported as income.

27. If I entered into a contract in 1918 which will not be completed until 1919, and which requires me to make expenditures for material and labor, provide for possible losses, etc., must I include the advance payments I receive in 1918 in my return for that year?

It is optional with you to await the completion of the contract. As you are unable to determine what amount of gain or profit you will derive from the contract until it is completed, the payments received thereon during 1918 need not be included in your return for that year, and in such case the expenses will not be charged until the completion of the contract. When the contract is completed the net gain or profit derived therefrom should be reported under "gross income" in your return rendered for the year 1919.

28. A tenant, under the terms of a lease, is required to pay a certain cash rental and in addition make certain improvements. Is the cost of these improvements held to be taxable income to the property owner?

Report cash rental for year in which received. The value of the improvements at the expiration of the lease is income for that year to the owner.

29. Special payments, designated as "Bonuses," are often made to officers and employees of corporations, firms, and individuals. Are such items of income subject to tax in the hands of recipients?

Any bonus or other item of compensation paid to an employee in addition to his regular salary or wage under a contract, express or implied, as additional compensation for services rendered as a reward for past endeavors, or as a stimulus to further zeal and enthusiasm in the discharge of his duties, is held to constitute taxable income which should be reported under "Gross income" in the employee's return rendered for the year during which received.

30. Should an individual who conducts a grocery, dry-goods, clothing, or farm-implement business, or any other business which requires that a stock be carried, take an inventory at the close of each taxable year and take such inventories into consideration in arriving at his net income from business?

Yes. Section 203 of the Revenue Act of 1918 provides that whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may approve or prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income of the taxpayer.

31. How am I to determine the amount of gain or profit derived from a sale of property which is returnable for income-tax purposes?

If you acquired the property sold prior to March 1, 1913, you should take its fair market price or value as of that date, add thereto all amounts subsequently expended in making permanent improvements, then deduct the depreciation sustained, and the difference between the result thus obtained and the selling price is the amount to be reported under "Gross income."

If you purchased the property on or after March 1, 1913, the difference between its cost, plus all amounts subsequently expended for permanent improvements less depreciation sustained, and its selling price is to be returned.

If the property came to you on or after March 1, 1913, as an inheritance, the difference between the appraised value placed upon it at that time, plus all amounts subsequently expended for permanent improvements less depreciation sustained, and its selling price is to be returned.

32. How is the value as of March 1, 1913, of property sold determined?

No method of determining this value can be stated which will adequately meet all circumstances. What that value was is a question of fact to be established by any evidence which will reasonably or adequately make it appear.

33. I owned property which I traded for other property during 1918. How am I to determine what amount of gain

or profit derived from the transaction is to be reported for income-tax purposes?

The profit is to be determined in the same manner as if the property was sold for cash, except that the property received in exchange should be treated as the equivalent of cash to the amount of its fair market value at the time of the exchange.

34. A piano dealer sells an instrument under a contract which states that payment therefor is to be made in monthly installments. How is the latter to report the amount of profit derived from this transaction?

It is held that every dollar received under such a contract represents in part the return of a portion of the cost of the article to the dealer and a portion of the profit to be derived from the transaction, and that the amount of profit represented by all the payments during the tax year should be reported in the dealer's personal return rendered for that year. For example, a piano which cost the dealer \$300 is transferred to another under a contract calling for 20 monthly payments of \$20 each, a total of \$400. Each monthly payment represents a return of capital amounting to \$15 and a profit amounting to \$5, and multiplying this latter amount by the number of payments received during the year yields the amount to be returned as income for that year.

If for any reason the purchaser defaults in his installment payments and the dealer repossesses the property, the entire amount received on the installment payments less the profit originally returned will be income to the dealer to be so returned for the year in which the property was repossessed, and the property will be taken back into the inventory at its cost.

35. Are commissions on renewal premiums on insurance policies subject to income tax?

Yes; such commissions received by insurance agents on account of business written are taxable income for the year in which received.

36. I purchased a 6 per cent \$100 coupon bond at its face value, plus \$1.50; that is, three months' accrued interest. Three months later I detached a coupon therefrom and collected \$3 interest. Must the entire amount of interest received be returned as income?

No. Report only so much interest as accrued after the date of your purchase. It is the seller's duty to report the balance.

37. Do the pensions and retired pay of ex-officers and men of the United States military and naval forces not on active duty constitute items of taxable income?

Yes.

38. I own stock in a bank which, under a State law, is required to pay the taxes assessed against such stock. How is this matter to be handled for income-tax purposes?

The proportionate part of the entire amount of taxes so paid by the bank, which is properly chargeable against the number of shares held by you, should be reported, for surtax purposes, in your personal return, as a dividend, and then claimed as a deduction under the heading of "Taxes."

39. In 1915 I purchased 10 shares of the preferred stock of a corporation and received 10 shares of common stock as a bonus. Has the value of this bonus a taxable status?

No; but the total purchase price is to be fairly apportioned between the stock and securities received as a bonus, for the purpose of determining the proportion of the consideration attributable to each class of stock. The cost of each class so determined will be the basis for determining profit or loss upon the subsequent sale of such stock.

40. Are amounts placed to the credit of a shareholder in a building and loan association subject to income tax?

Any amount credited to a shareholder when the title to such credit passes to the latter at the time of the credit has a taxable status, and should be included in the return rendered for the year during which the credit is made.

Where the amount of accumulations credited does not become available to the shareholder until the maturity of a share it need not be reported as income, until maturity of the share, when the amount received in excess of the total amount actually paid in by the shareholder is to be returned.

41. I hold stock in a corporation which in 1918 increased its capital stock and gave me the right to subscribe for additional stock at par. If I sell this "right," are the proceeds to be returned for tax purposes?

Yes; the entire proceeds from the sale of a "right" to purchase additional stock should be included in the return as income.

42. Are payments of alimony to be returned for tax purposes by the recipient?

Alimony is not held to be income to the recipient, nor is it held to be such an item as is allowable as a deduction to the person paying the same.

43. Where service is rendered for a stipulated price, wage, or salary, and paid with something other than money, shall consideration be given the transaction for income-tax purposes?

Yes. Where services are paid for with something other than money the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary such price will be presumed to be the fair value of the compensation received.

DIVIDENDS.

44. The net earnings of a corporation in which I held stock in the year 1917 amounted to \$50,000, which amount was carried to a surplus account. Its net earnings from January 1 to October 31, 1918, amounted to \$70,000, and on this latter date these last earnings were carried to surplus and a stock dividend of \$50,000 declared and paid. What income taxes are to be assessed against this dividend?

Section 201(d) of the revenue act of 1918 provides in part that if any stock dividend is received by a taxpayer between January 1 and November 1, 1918, both dates inclusive, or is during such period bona fide authorized or declared and entered on the books of the corporation and is received by a taxpayer after November 1, 1918, and before the expiration of 30 days after the passage of that act, then such dividend shall be taxed to the recipient at the rates prescribed by law for the years in which the corporation accumulated

the earnings or profits from which such dividend was paid, but the dividend shall be deemed to have been paid from the most recently accumulated earnings or profits.

Paragraph (e) of the same section of the act provides in part that any distribution made by a corporation to its shareholders during the first 60 days of any taxable year shall be deemed to have been paid from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution to the extent of such earnings or profits.

Therefore, the dividend to which you refer is to be charged against the \$70,000 earned during 1918 and carried to surplus on the day the dividend was declared, and it will be subject to the surtax at the rates prescribed by the revenue act of 1918.

45. Suppose that instead of declaring a stock dividend of \$50,000, this corporation had, on October 31, 1918, declared a stock dividend of \$100,000, payable December 31, 1918?

If such had been the case, the entire amount of net earnings carried to surplus on October 31, 1918, would have been subject to surtax at the same rates as the dividend mentioned in your inquiry next above, and the balance, or \$30,000, would have been held to have been paid from the 1917 earnings and would have been subject to surtax only at the rates prescribed in the act of October 3, 1917.

46. Assuming that instead of paying this dividend in stock, the corporation paid it in cash. Would this dividend be taxable?

Yes. Under the provisions of sections 201 and 213 of the revenue act of 1918 cash dividends are to be returned for the taxable year in which received and are taxable at the rates for that year regardless out of what earnings they are paid, except that any earnings or profits accumulated prior to March 1, 1913, may be distributed in cash or stock, exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.

47. In 1918 I received a dividend of \$10,000 from company "A," which was paid in stock of company "B." Is this \$10,000 to be considered a stock dividend within the meaning of the income-tax law?

No: a stock dividend is a distribution by a corporation to its stockholders of capital stock of the distributing corporation. A distribution of stock other than that of the distributing corporation is not a stock dividend but is the equivalent of a cash dividend and is taxable as such.

48. A corporation began business January 1, 1912. Its net earnings were as follows:

Jan. 1, 1912, to Mar. 1, 1913.....	\$10, 765
Mar. 1, 1913, to Jan. 1, 1914.....	5, 220
For the year 1914.....	7, 347
For the year 1915.....	11, 000
For the year 1916.....	15, 300
For the year 1917.....	27, 400
Jan. 1 to Oct. 31, 1918.....	30, 000

Amount of surplus on hand Dec. 31, 1918..... 107, 032

The corporation never paid a dividend until October 31, 1918, on which date it declared and paid a stock dividend of \$107,032. How will this dividend be taxed?

That portion of the dividend which represents the distribution of 1918 earnings, or \$30,000, will be subject to the surtax at the rates prescribed in the revenue act of 1918; that portion which represents 1917 earnings, or \$27,400, at the rates prescribed in the act of October 3, 1917 only; that portion which represents 1916 earnings, or \$15,300, at the rates of additional tax prescribed in the act of September 8, 1916, only; and that portion which represents earnings which accrued from March 1, 1913, to January 1, 1916, at the rates prescribed in the act of October 3, 1913. The remainder, or \$10,765, is exempt from tax under section 201 (b) of the revenue act of 1918. If the stock dividend had been declared after November 1, 1918, all except \$10,765 is taxable at 1918 rates.

49. Will it be the taxpayer's duty to advise himself of what proportion of a stock dividend received by him is properly chargeable, under section 201 (d) of the revenue act of 1918, to the corporate earnings or profits for each tax year?

Yes.

50. My net income for 1918 was \$20,000, excepting that in addition to this \$20,000 I received before November 1 a stock dividend of \$65,000, which was paid out of corporate earnings, as follows:

1917-----	\$20, 000
1916-----	20, 000
Mar. 1, 1913, to Dec. 31, 1915-----	15, 000
Jan. 1, 1912, to Mar. 1, 1913-----	10, 000
Total-----	65, 000

How would the tax on this \$65,000 be computed?

The tax on the \$65,000 in question is to be computed as follows:

Total net income for 1918-----	\$20, 000
Dividends from 1917 earnings-----	20, 000
	40, 000
Surtax at 1917 rate (8 per cent of \$20,000, the amount of net income between \$20,000 and \$40,000)-----	\$1, 600
Dividends from 1916 earnings-----	20, 000
	60, 000
Surtax at 1916 rate (2 per cent of \$20,000, the amount of net income between \$40,000 and \$60,000)-----	400
Dividends from earnings from Mar. 1, 1913, to Dec. 31, 1915-----	15, 000
	75, 000
Surtax at rate for 1913, 1914, and 1915 (2 per cent of \$15,000, the amount of net income between \$50,000 and \$75,000)-----	300
Total-----	2, 300

The remaining \$10,000 earned before March 1, 1913, is not subject to tax.

51. Assuming that a corporation had assets which had greatly appreciated in value and had carried the amount of that appreciation to its surplus account and capitalized same, or that it capitalized its good will, and then issued the new stock to its shareholders as a dividend, would this dividend be subject to tax?

Stock dividends declared from surplus created by the revaluation of capital assets or by placing a value upon trade-marks, good will, etc., do not represent a distribution of earnings or profits subject to tax as a dividend in the hands of the recipient shareholder. When stock received in payment of such dividend, or stock in respect of which any such dividend was paid, is sold, the cost of each share of stock, whether old or new, for the purpose of ascertaining the gain or loss resulting from its sale, is the quotient of the cost of the old stock, if acquired on or after March 1, 1913, or its fair market value as of that date if acquired prior thereto, divided by the number of old and new shares added together. The profit so ascertained from the sale of such stock is income subject to both normal and surtax and shall be accounted for in the shareholder's return rendered for the year in which the sale is made.

52. Are dividends on paid-up life insurance policies subject to income tax?

Dividends on paid-up life insurance policies are not subject to normal tax but are subject to the surtax for the year in which received.

DEDUCTIONS.

53. What items may I deduct in ascertaining my net income from all sources?

In arriving at your net income from all sources you are entitled to deduct from gross income the following items:

(a) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including allowance for salaries or other personal services actually rendered, including rentals or other payments required to be made as a condition to the continued use or possession for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917) the interest upon which is wholly exempt from income tax.

(c) Taxes paid or accrued within the taxable year imposed by the authority of the United States, except income, war-profits, and excess-profits taxes; or by the authority of any of its possessions, except the amount of income, war-profits, and excess-profits taxes allowed as a credit under section 222 of the act; or by the authority of any State or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed; and by the authority of any foreign country, except the amount of income, war-profits, and excess-profits taxes allowed as a credit under section 222 of the act.

(*d*) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business.

(*e*) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with one's trade or business.

(*f*) Losses sustained during the taxable year of property not connected with the trade or business, if arising from fires, storms, shipwreck, or other casualty or from theft, and if not compensated for by insurance or otherwise.

(*g*) Debts ascertained to be worthless and charged off during the taxable year.

(*h*) A reasonable allowance for the exhaustion, wear, and tear of property used in trade or business, including a reasonable allowance for obsolescence.

(*i*) A reasonable allowance for depletion in the case of mines, oil and gas wells, other natural deposits and timber.

(*j*) Contributions or gifts made within the taxable year to corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to the special fund for vocational rehabilitation authorized by section 7 of the vocational rehabilitation act, to an amount not in excess of 15 per cent of your net income from all sources as computed without the benefit of this paragraph.

54. What constitutes an item allowable as a deduction as a business expense?

All amounts of expenses paid or incurred during the taxable year in the conduct of a business, trade, or profession.

This includes all amounts paid by a farmer for labor in preparing his land for a crop and the cultivation, harvesting, and marketing of the crops, the cost of the seed and fertilizer used; the amounts expended for labor used in caring for live stock and the cost of the feed. The amounts actually paid in making repairs to farm buildings, but not the dwelling house, repairs to fences, farm machinery, etc., the cost of materials for immediate use and farm tools which are used up in the course of a year or two, such as binding twine, stock powders, pitchforks, spades, etc.; and the amount of rent paid for a farm may also be claimed.

A merchant may claim as deductions the amounts paid for advertising, hire of clerks and other employees; the cost of the light, fuel, water, telephones, etc., used in or at his place of business; drayage and freight bills; the cost of operating delivery wagons, trucks, and the repairs to same.

A physician may claim as deductions the cost of medicines and medical supplies used by him in the practice of his profession, expenses paid in the operation and repair of an automobile used in making professional calls, dues to medical societies and subscriptions to medical journals, the expenses of attending medical conventions, the rent paid for office rooms and the hire of office assistants, the cost of the fuel, light, water, telephone, etc., used in such office rooms. Amounts expended for books, medical supplies, and surgical instruments of a permanent character are not allowable as deductions.

This in a general way outlines the ordinary and usual expenses incurred by a farmer, a merchant, or a professional man, which may be claimed as deductions, and the principles underlying these allowances are equally applicable in the case of anyone engaged in a business, trade, or profession. In short, all expenses connected directly and solely with the conduct of an income-producing business, trade, profession, or vocation are allowable.

Items of personal expense or items connected in any way with the support, maintenance, and well-being of a family are not allowed; neither are the amounts paid for tools, implements, vehicles, machinery, or surgical instruments which are more or less permanent in character, nor the cost of medical, law, or other professional books, nor amounts expended in making permanent improvements or betterments of any kind whatsoever, allowable as deductions. These latter items are held to be investments of capital upon which depreciation may be claimed.

No expenses or depreciation in connection with a taxpayer's personal residence, or automobiles or other property used for pleasure can be properly deducted under the provisions of the income-tax law, as such expenses and depreciation represent "personal living or family expenses."

55. If I employ a minor son or daughter to assist me in my business or trade and I pay a salary or wage for such assistance, may I claim the amount as a deduction?

No. If, however, the son or daughter has attained his or her majority, the amount of compensation paid for his or her services may be so claimed.

56. Can a taxpayer claim a deduction for his own remuneration?

Wages or salary drawn by a taxpayer from his own business are more in the nature of a charge out of profits than a charge against profits. If such could be deducted they would merely be added to his income, the effect of which would be to take money out of one pocket and put it in another. Therefore no deduction can be claimed for income-tax purposes.

57. Can the amounts expended by a business man in entertaining out-of-town customers, or prospective customers, be claimed as deductions?

Yes. If the sole purpose of the business man in making such expenditures is to cultivate the good will of his customers and secure an increase in trade they may be so claimed.

58. A, who is employed in a city, has his home in a suburb. He pays car fare between his home and place of employment and takes his noon lunch in the city. Can the amounts expended for car fare and lunch be claimed as a business expense?

No: such amounts are held to be items of personal expense.

59. Can a salesman claim as deductions the amounts expended for railroad fare, excess baggage, taxicab or street-car fare, show rooms, assistants, advertising, meals, and lodging?

All amounts actually expended for necessary expenses, including necessary traveling expenses, by salesmen, actors, and others travel-

ing in the course of employment or business, except amounts paid for expense incident to service rendered which are reimbursable, and excepting expenditures for meals and lodging not paid from per diem allowances received in lieu of subsistence while under traveling orders, constitute allowable deductions in returns of income under the provisions of the income-tax law.

Amounts paid out for expenses for meals and lodgings by individuals traveling in the course of employment are properly deductible from gross income only when such amounts are paid from per diem allowances received in lieu of subsistence while under traveling orders. All per diem allowances should be included in gross income. When under the terms of employment no part of the per diem allowance is given specifically to cover meals and lodging, the total amount spent for meals and lodgings while traveling not exceeding for any year the total amount of allowances received, may be deducted.

Amounts paid out for expenses incident to services rendered, which are reimbursable, are not deductible as expenses nor are they to be returned as income when received in reimbursements.

60. Are the items of expense incurred and paid by me during the taxable year in connection with a farm which I lease to another on a cash or crop-share rental basis, such as repairs to fences, farm buildings, etc., allowable as deductions?

Yes.

61. Can the amount of life insurance premiums and premiums paid for insurance on my residence be claimed as deductions?

No; these are held to be items of personal expense. If, however, a farmer pays premiums on insurance policies covering farm buildings, other than your dwelling house, or on any property used for business purposes, these premiums are allowable as deductions.

62. An individual or a partnership insures the life of one or more employees or members. Can the premiums paid for such insurance be considered a business expense and claimed as a deduction?

Section 215 of the revenue act of 1918 specifically provides that no deduction shall be allowed for premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

63. A tenant, under the terms of a lease, is obligated to pay a certain cash rental on property used for business purposes and all taxes assessed against the property and to keep it insured. May he claim as a business expense the aggregate amount of rental, taxes, and insurance premiums paid?

Yes; if the property is used by the tenant for business or trade purposes and not as a home, the aggregate amount may be claimed as a deduction for the year during which actually paid.

64. I own stock in a corporation which, in 1918, assessed each of its stockholders \$50 on each share held. Can the amount paid by me be claimed as a deduction?

No. Assessments made by a corporation on its capital stock are regarded as further investments of capital and do not constitute an allowable deduction in the return of the individual.

65. You say that assessments made against corporation stockholders can not be claimed as deductions. In California and other States fruit growers, ranchers, and farmers are shareholders in irrigation companies which are mutual in character, and they are often assessed in proportion to their holdings of stock, for sufficient amounts to make repairs to the irrigation system, cleaning out of pipes, laterals, etc. Can such assessments not be claimed as deductions under the head of business expenses?

Yes. Where the purpose of the assessment is merely to raise funds to keep the irrigation system in usable condition and not to make extensions or betterments, the amount assessed against each shareholder may be so claimed.

66. If a physician or other professional or business man rents a home and uses a portion of it for professional or business purposes, may any portion of the rent paid for that home be claimed as a business expense?

Yes. The proportion of the rent paid which is properly chargeable to the number of rooms used for professional or business purposes may be claimed as a deduction.

67. In 1918 I purchased a property, the title to which proved defective, and in order to straighten the matter out I employed an attorney and resorted to court proceedings. Can I claim a deduction to cover the fee paid the attorney and the court cost?

No. Such items are held to be a part of the cost of the property and therefore not allowable as deductions.

68. If I employ an architect to prepare plans for a building to be used for business purposes, may the fee paid to the architect be claimed as a business expense?

No. Amounts expended for an architect's services are held to be a part of the cost of the building and not such items as may be claimed as deductions.

69. Can a business or professional man who keeps a set of books and enters thereon as income sales of goods on credit, or fees earned but not paid, and charges to expense account items which have not been paid by him, report his net income for the year as shown by his books when they are balanced at the end of the taxable year?

Yes. Section 212 of the revenue act of 1918 provides that net income shall be computed in accordance with the method of accounting regularly employed in keeping the taxpayer's books. The method employed must, of course, clearly reflect the taxpayer's net income.

70. If I have a certain sum of money invested in a farm or business, may I claim as a deduction, under the head of interest, an estimated amount of interest which might have accrued to me had that money been deposited in a bank or invested in interest-paying securities?

No.

71. What forms of taxes are not deductible on account of being taxes assessed against local benefits?

Taxes assessed against an individual on property owned by him to pay for the paving of a street contiguous to his property, the construction of a sewer, sidewalk, etc., or the construction of ditches to drain property owned by him, can not be claimed as deductions. In short, taxes as are not general in nature and are levied on account of some work or privilege the benefit of which accrues to a limited number of property owners, of which the taxpayer is one, are not allowable deductions.

72. If I pay any amount of Federal personal income tax for the year 1917, may I claim that amount as a deduction for the year 1918?

No. The income-tax law states that income taxes are not allowable as deductions. Under this provision income tax paid in 1918 on income received in 1917 or any previous year can not be deducted. State income taxes are deductible.

73. In 1917 I bought certain stocks and bonds for \$5,000, and in 1918 the value of these securities dropped to \$4,000. May I claim the difference of \$1,000 as a loss in computing my income-tax liability?

No. Under the provisions of section 214 of the revenue act of 1918 only such losses as have been sustained during the taxable year can be claimed; that is, the loss must have resulted from a completed and closed transaction. In your case you still own the securities. They may go up in value during 1919, and until they are sold or otherwise disposed of you are unable to determine whether you will suffer a loss or derive a gain from the investment. In other words, no account is to be taken for income-tax purposes, of fluctuations in the market value, or arbitrary changes in the book value of securities or other property.

(NOTE.—*This ruling has been modified in the case of securities owned by dealers in securities. See T. D. 2609 and T. D. 2649.*)

74. John Doe, while driving an automobile for pleasure, ran down and injured another person. He either paid over a certain sum or paid a judgment rendered against him in settlement of the injury done. Can he claim the amount so paid as a loss?

No. It was not a loss which was incurred in the conduct of his business or trade, or which resulted from a transaction entered into for profit.

75. How am I to determine what amount of loss, resulting from a sale of property, is allowable as a deduction?

The same method of computation should be followed as is outlined in the answer to the thirty-first question.

76. A professional man or a merchant owns and operates a "fancy stock farm" for recreation or pleasure. The expenses of operation exceed the gross receipts. Can the difference be claimed as a deduction under the head of "losses"?

No. It is held that where a farm is operated for purposes of recreation or pleasure and not for gain or profit and the expenses of operation exceed the gross receipts, that farm is not to be classed as a commercial enterprise, and it does not form a part of its owner's

business or trade. The gross receipts are not to be reported under "Gross Income" and the expenses are not to be claimed as a deduction. This ruling, of course, precludes the claiming of the difference between the two amounts as a loss.

77. Suppose I buy a farm which is much run down with the intention of making it a profit-paying property; that is, I intend to operate it for profit and not for recreation or pleasure. To do this I am obliged to expend large amounts for labor in plowing and cultivating the land, for fertilizer, lime, etc., and for several years the expenses will greatly exceed the gross receipts. Can the excess of expenses over receipts for each year be claimed as a loss?

It is held that all such necessary expenses as contemplated by the income-tax law, of cultivating, operating, or managing a farm on a basis embodying the recognized principles of commercial farming, for the purpose of gain or profit and not for recreation or pleasure, may be claimed as deductions in returns of income, even though these expenses exceed the income from the farm and the result is a continual loss, provided the farm is continued to be operated on a strictly commercial basis.

78. I own a tract of timber which was partially destroyed by fire during 1918. Is this loss allowable as a deduction?

The actual amount of capital invested in standing timber, if acquired on or after March 1, 1913, and later destroyed by fire, may be claimed as a deduction if not reimbursed by insurance or otherwise. If the timber was acquired prior to March 1, 1913, its fair market price or value as of that date may be claimed. To illustrate the method to be employed in computing the amount of loss allowable as a deduction, the following is submitted: A tract of land was acquired prior to March 1, 1913, and the estimated amount of timber standing on that tract on that date was 1,000,000 feet, board measure, the fair market price or value per 1,000 feet established by the current prices prevailing in the locality of the tract in question as of March 1, 1913, being \$4. During the year 1918, 400,000 feet of this timber was destroyed by fire. In this case \$1,600 is the amount which may be claimed as a deduction.

79. If a crop which is ready to be harvested, but has not been gathered, or a crop which has been harvested, but has not been sold, is destroyed by storm, flood, or fire, can the value of that crop be claimed as a deduction?

No; unless the value has been reported as income. It is understood, of course, that the actual cost of producing or harvesting a crop which has been so destroyed may be claimed as a deduction under the head of business expense.

80. What conditions are necessary in order that a debt may be claimed as a deduction?

It must be (a) a bona fide debt, (b) definitely ascertained to be worthless and uncollectible during the year for which the deduction is made, and (c) if books are kept it must be charged off within the year for which the deduction is claimed and no longer considered an asset or carried as such on the books.

81. In 1918 a corporation or a firm to which I had loaned money since March 1, 1913, became bankrupt. Can this debt

be considered absolutely worthless and claimed as a deduction for 1918?

Yes; if it is definitely known that nothing can be collected from the debtor itself or any person connected with it.

82. Is it absolutely necessary that the debtor corporation or firm mentioned in the preceding inquiry be declared a bankrupt and its receiver discharged before I can claim a deduction on account of the debt in question?

No. If the debtor corporation has no assets whatsoever available for application to the debt in question, and it is definitely known that nothing whatsoever can be collected from debtor itself or any person connected with it, a creditor need not go to the expense of instituting bankruptcy proceedings in order to establish his right to claim the worthless debt as a deduction.

83. "A" indorses a note for "B." The latter has since departed for parts unknown, and the note became due in 1918, and "A" was required to make good his indorsement. Can he now claim as a deduction the amount paid by him to the creditor?

Yes.

84. If, on account of friendship or relationship, I advanced a certain sum to assist a needy friend or relative, and at the time such advance was made I had little or no reason to expect that the amount so advanced would ever be returned, may I now claim a deduction to cover such advance?

No. Such an advance is regarded as a gift and is not held to constitute a bona fide debt.

85. In rendering my 1915 return I claimed a deduction to cover a debt I then believed to be absolutely worthless. In 1918 the debtor has discharged a part of his obligations. How should I treat this payment for income-tax purposes?

Consider it as an item of income and include the amount in your 1918 return.

86. A professional man earned a fee in 1917. As he keeps no books, he reports his income for tax purposes on a cash-receipt basis. As this fee has never been reported as income, can it be claimed as a deduction if collection can not be made?

No; never having been returned as income, it can not be claimed as a deduction.

87. "A" loaned "B" \$10,000, the debt being secured by a mortgage on a farm. Foreclosure proceedings were resorted to, and "A," to protect his interests, purchased the farm for \$8,000. Can the difference between these two amounts be claimed as a deduction?

Where, under foreclosure, the mortgagee buys in the mortgaged property, the difference between the purchase price and the debt will not be allowed as a deduction. The property which was security for the debt being in the possession and ownership of the mortgagee, is, for purposes of the income tax, held to be sufficient to justify the disallowance of a claim for bad debts. Where the purchaser of the property upon foreclosure is another than the mortgagee, the latter may deduct as a loss the difference between the amount of the debt and the net amount received by the mortgagee.

DEPRECIATION.

88. At what rates may depreciation be claimed and under what conditions?

The deduction for depreciation in income-tax returns is a means whereby exemption from the tax may be secured upon the amount of capital invested in physical property (or in case of property acquired by gift or bequest the value of such property) which is subject to exhaustion through wear and tear arising out of its use or employment in business or trade or on account of obsolescence. Therefore, the annual allowance for depreciation should be based upon the life of the property; that is, the cost of the property or the value of the same where acquired by gift or bequest or its fair market price or value as of March 1, 1913, if acquired prior thereto, should be ratably spread over its life. For instance, the rate of depreciation to be deducted on buildings used for business purposes, the probable life of which is 50 years, would be 2 per cent. The probable life means, of course, the number of years the property would be usable in business from the date of acquisition or in case of property acquired prior to March 1, 1913, the number of years the property would be usable from March 1, 1913. In the case of property acquired by gift or bequest, the "cost" of such property for depreciation purposes is the appraised value at the time the property was acquired. If property in respect of which depreciation is claimed was acquired prior to March 1, 1913, the fair market value as of that date will be assumed to be in the absence of proof to the contrary the cost of the property less depreciation up to that date.

In claiming depreciation the following fundamental principles must be taken into consideration:

(a) Only such depreciation as results from exhaustion, wear and tear of property, arising out of its use or employment in business or trade, or on account of obsolescence, can be claimed. Depreciation in the value of a home or any article of property, such as automobiles used for personal pleasure or convenience, can not be claimed; the property must be used for the purpose of producing income.

Depreciation in the value of land, whether improved or unimproved, due to ordinary erosion, exhaustion, or any other cause, can not be claimed.

Where, in the course of years, the owner of property has claimed its full cost as depreciation in his income-tax returns, no further claim will be allowed.

The value to be cared for by depreciation is the actual amount invested in the property and not the value which may be arbitrarily or otherwise fixed.

(NOTE.—For information relative to deduction for obsolescence see Regulations 45.)

89. I bought a patent for \$5,000 which, under the patent laws of the United States, had five years yet to run. As the value of this patent depreciates each year on account of the exhaustion of the patent period, may a deduction be claimed?

Yes. The cost of the patent divided by the number of years it has yet to run yields an amount which may be claimed each year as depreciation. In your case this amount is \$1,000.

90. I understand that depreciation in the value of articles for personal use can not be claimed as a deduction. However, as actors and actresses are often required to furnish their own wardrobes, does not the depreciation in the value of such property constitute an allowable deduction?

If costumes purchased by members of the theatrical profession are used exclusively for the production of a play and are not adapted for occasional personal use, and are not so used, a deduction may be claimed on account of such depreciation in their value as occurs during the year on account of wear and tear arising from their use in the production of the play or from their becoming obsolete at the close of the production. In such case the cost of the wardrobes in the first instance must not have been claimed as an expense.

DEPLETION.

91. Under what conditions and at what rates may depletion due to the removal of a natural product from oil or gas wells, mines, quarries, etc., be claimed?

Section 214, paragraph 10, of the revenue act of 1918, states how the amount of depletion allowable as a deduction is to be ascertained, but as so many factors are to be considered in computing depletion, an answer which will be applicable in all cases where depletion occurs can not here be given. Such factors are covered in considerable detail by the regulations, copies of which may be obtained from the collector of internal revenue for your district, and where these regulations do not afford all the information necessary in your particular case a detailed statement covering all the facts and figures in your case should be forwarded to the collector with a request for a ruling.

CONTRIBUTIONS AND GIFTS TO RELIGIOUS, CHARITABLE, AND SCIENTIFIC ORGANIZATIONS, ETC.

92. With reference to the eleventh paragraph of section 214 of the act, how am I to determine to what extent contributions or gifts made to corporations, organized and operated exclusively for religious, charitable, scientific, or educational purposes or for the prevention of cruelty to children or animals or to the special fund for vocational rehabilitation, may be claimed as a deduction?

You should first ascertain what your taxable net income would be were you not entitled to a deduction on account of such contributions or gifts, and then if the aggregate of your contributions and gifts made during the year to such organizations does not exceed 15 per cent of your taxable net income so computed their aggregate amount may be entered in the space provided therefor under "General deductions" on a personal return form. If such aggregate amount exceeds 15 per cent of your taxable net income so computed, the excess can not be claimed.

For example: Your total taxable net income amounts to \$20,000. During the year you have contributed to the American Red Cross \$1,000, to the Young Men's Christian Association \$1,000, toward the construction of a new church \$1,000, and to the Associated Charities

of your home city \$500, a total of \$3,500. Fifteen per cent of your total net income amounts to \$3,000. Therefore this latter amount may be claimed as a deduction and the balance of your contributions and gifts may not be claimed.

In claiming a deduction on account of such contributions or gifts there should be shown on the return of income (a) the name and address of each organization to which a contribution or gift was made and (b) the date and amount of each such contribution or gift.

Where the contribution or gift was other than money the basis for calculation of its value shall be the fair market value of the property given at the time of contribution or gift.

93. During 1918 I contributed \$100 toward the support of a needy family. May this contribution be claimed as a deduction?

Contributions or gifts made to individuals do not constitute allowable deductions.

RATE OF TAX.

94. Upon what is the surtax based?

The surtax imposed by section 211 of the act is based upon the total amount of net income from all sources in excess of \$5,000.

95. A prospector discovers a mine, which he sells at a large profit. Is the entire profit derived from the sale of the mine subject to the surtax imposed by section 211?

Section 211 of the act provides that in the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the surtax attributable to such sale shall not exceed 20 per cent of the selling price of such property.

96. In computing my income subject to normal tax, to what credits against my net income from all sources am I entitled?

For the purpose of the normal tax only you are entitled to the following credits:

(a) The amount received as dividends from corporations which are taxable upon their net income and amounts received as dividends from personal-service corporations out of earnings or profits upon which income tax has been imposed.

(b) The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation which has been included in gross income.

(c) The amount of personal exemption specified in the answer to question 17.

(NOTE.—For information in regard to further credits see section 222 of the act.)

97. What is the rate of normal tax imposed by section 210 of the act for the taxable year 1918?

Section 210 of the act provides that there shall be levied, collected, and paid upon the net income of each individual for 1918 a normal tax of 12 per cent of the amount of the net income in excess of the credits specified in the answer to question 96, except that in the case of a citizen or resident of the United States the rate upon the first \$4,000 of such excess amount is 6 per cent.

PARTNERSHIPS.

98. Are partnerships subject as such to the Federal income tax and required to render annual income-tax returns?

Section 224 of the act provides that every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

Section 218 of the act provides that individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.

This section of the law also provides that a partner shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits specified in the answer to question 96, his proportionate share of such amounts specified in paragraphs (a) and (b) of that answer as are received by the partnership. Section 218 further provides that if a fiscal year of a partnership ends during a calendar year for which the rates of tax differ from those for the preceding calendar year, then (1) the rates for such preceding calendar year shall apply to an amount of each partner's share of such partnership net income equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to the remainder.

In the case of an individual member of a partnership which makes return for a fiscal year beginning in 1917 and ending in 1918, his proportionate share of any excess-profits tax imposed upon the partnership under the revenue act of 1917 with respect to that part of such fiscal year falling in 1917, shall, for the purpose of determining the tax imposed by this title, be credited against that portion of the net income embraced in his personal return for the taxable year 1918 to which the rates for 1917 apply.

The net income of the partnership is to be computed in the same manner and upon the same basis as provided for individuals except the deduction referred to in paragraph (j) of the answer to question 53 is not allowable.

FIDUCIARIES.

99. Who are classed as fiduciaries?

The term "fiduciary" is one that applies to all persons or corporations that occupy positions of peculiar confidence toward others, such as trustees, executors, or administrators, and a fiduciary for

income-tax purposes is any person or corporation that holds in trust an estate of another person or persons.

There may be a fiduciary relationship between an agent and the principal, but the word "agent" does not denote a "fiduciary" within the meaning of the income-tax law.

A fiduciary relationship for the purposes of the income tax can not be created by a power of attorney. An agent having entire charge of property, without authority to effect and execute leases with tenants entirely on his own responsibility, and without consulting principal, paying taxes and expenses, and all other charges in connection with the property out of funds in his hands from collections of rents, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by power of attorney, is not a "fiduciary" within the meaning of the income-tax law. In all cases where no legal trust has been created in the estate controlled by the agent and attorney the liability under the law rests with the principal.

100. Is the duly appointed guardian of a minor or the conservator of an estate of an incompetent person required to render personal returns for and in behalf of his ward?

Yes; under the same conditions as would the ward if competent to act for himself, and in so doing the personal exemption to which the ward is entitled may be claimed.

101. Is the duly appointed administrator of an estate of a deceased person who died during the tax year required to render a personal return for and in behalf of the deceased, and also his estate?

If the net income of the deceased from January 1 of the year during which he died to the date of his death equaled or exceeded \$1,000 in the case of an unmarried person or \$2,000 in the case of a married person, the administrator should file a personal return, executed on Form 1040, for and in behalf of the deceased and a return executed on the same form will also be required of him for and in behalf of the estate, if it remains in process of administration and its net income from the date of the decedent's death to December 31 not properly paid or credited to any beneficiary equals or exceeds \$1,000.

The administrator will be required to pay and will be held liable for any amount of tax which may be assessed against any such return rendered by him.

If the amount of net income properly paid or credited to any beneficiary equals or exceeds \$1,000, a separate return on Form 1041 should be made covering such payments.

If any portion of the net income of an estate during the process of administration is paid or credited to a nonresident alien beneficiary, a return is required, and the normal income tax of 8 per cent is to be deducted and withheld from so much of the amount paid or credited to such beneficiaries as was not derived from dividends from corporations subject to tax or which has been subject to withholding of the normal tax at the source. A separate return on Form 1040 is also required for each nonresident alien beneficiary of such estates.

102. Is the trustee having charge of a trust estate, the net income of which is periodically distributed among the beneficiaries, required to render a return?

Every fiduciary, or at least one of joint fiduciaries, must make a return (a) for the individual whose income is in his charge, if the net income of such individual is \$2,000 or over, if married and living with husband or wife, or is \$1,000 or over in other cases, or (b) for the estate or trust for which he acts, if the net income of such estate or trust is \$1,000 or over or if any beneficiary of such estate or trust is a nonresident alien. The return in case (a) and also in case (b) if the tax is payable by the fiduciary shall be on Form 1040 (revised), except that it may be on short Form 1040 A (revised) where the net income does not exceed \$5,000. The return shall be on Form 1041 (revised) in case (b) if the tax is payable by the beneficiaries. If the net income of a decedent from the beginning of the taxable year to the date of his death was \$1,000, if unmarried, or \$2,000, if married, the executor or administrator shall make a return for such decedent.

103. For the purpose of the normal tax, what credits are allowed estates in the process of administration and estates held in trust for the accumulation of income?

In such cases the estate or trust is allowed the same credits as are allowed to single persons. (See answer to the 96th question.)

104. How is the net income of estates and trusts to be computed?

The net income of estates or trusts is to be computed in the same manner and on the same basis as provided for individuals, except that in lieu of the deduction for "contributions" specified in paragraph J of the answer to the 53d question, there is to be allowed as a deduction any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, or any corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder, and in cases of income which is to be distributed to the beneficiaries periodically and in cases of income collected by a guardian of an infant to be held or distributed as the court may direct, the fiduciary should include in the return a statement of each beneficiary's distributive share of such net income, whether or not distributed before the close of the taxable year for which the return is made.

105. In a case where an estate is in process of administration and the fiduciary renders returns covering the income and deductions of the estate, and pays the amount of normal and additional tax assessed thereon, will the net income be subject to tax in the hands of the beneficiaries when received by them?

No. The taxes having once been paid, such income is exempt from tax in the hands of the beneficiaries who receive the same.

106. Is any other than a return of income required of a fiduciary?

Yes. Fiduciaries come within the provisions of section 256, of the revenue act of 1918, and will be required to render to the Commissioner of Internal Revenue a return of information, if, during the taxable year, any income has been paid to an individual, partner-

ship, corporation, joint stock company, etc., equal to, or in excess of \$1,000.

107. Is a fiduciary required to deduct and withhold at the source any amount of normal income tax?

Yes. If any distribution or payment of fixed or determinable gain, profit, or income other than dividends or interest on tax-free bonds is made to a nonresident alien individual 8 per cent is to be deducted and withheld.

108. Is an ancillary administrator required to render income-tax returns covering income received by him?

An ancillary administrator is held to be merely the agent of the domiciliary administrator. The former should transmit to the latter all information as to income received by him in order that the domiciliary administrator may make a return covering the entire income of the estate.

109. Have the beneficiaries of an estate or trust a right to inspect income-tax returns rendered by a fiduciary covering the income of the estate or trust in which they are interested?

Beneficiaries are not entitled, as such, to an inspection of returns of income filed by such a fiduciary.

110. Who is liable for payment of the tax assessed against the net income of an estate or trust?

Liability for payment of the income tax attaches to the person of the fiduciary up to and including the date of his discharge.

111. I act as trustee of a trust estate. A part of the net income which accrues to the trust is retained and becomes a part of the corpus of the trust estate. Am I required to render a return for and in behalf of the trust other than the fiduciary return required of me?

If the trust itself is named as a beneficiary and the amount of net income which accrues to it as a beneficiary equals or exceeds \$1,000, a return executed on Form 1040, for and in behalf of the trust, in addition to the return executed on Form 1041, is required.

112. May an executor or administrator render his fiduciary returns prior to the close of the calendar year in a case where the estate is finally distributed and he is discharged from and relieved of his trust during that year?

An administrator or executor may, immediately after his discharge upon final accounting, file with the proper collector of internal revenue a return covering the income and deductions of the estate for the period January 1 to the date of his discharge. To such a return there should be attached a certificate, under seal, setting forth the fact of the final accounting and discharge of the administrator or executor, and the tax assessed against that return may be paid immediately after receipt from the collector of a notice of the amount assessed and a demand therefor.

113. Where, in the case of more than one trust, the creator in each instance is the same person, and the trustee in each instance is the same, how will the trustee account for the income of the several trusts?

The trustee should make a single return on Form 1041 for all the trusts in his hands, notwithstanding the fact that they arise from different instruments. When a trustee holds trusts created by different persons for the benefit of the same beneficiary he should make return

for each trust separately on Form 1041. This ruling is based on the identity of the trustee of the various trusts and not upon the identity of the beneficiary.

114. May the expenses of administration of an estate be claimed by the administrator as deductions in computing the estate's liability for income tax?

Expenses of administration, such as court costs, attorneys' fees, executor's commissions, etc., are chargeable against the corpus of the estate and are not allowable as deductions to the estate or the beneficiaries thereof.

115. May a fiduciary claim as a deduction the amount of depreciation estimated to have occurred in the value of property owned by the estate?

In the case of a trust estate, where the terms of the will or trust or the decree of a court of competent jurisdiction provides for keeping the corpus of the estate intact, and where physical property forming a part of the corpus of such estate has suffered depreciation through its employment in business, a deduction from gross income for the purpose of caring for this depreciation, where the deduction is applied or held by the fiduciary for making good such depreciation, may be claimed by the fiduciary in his return of income.

Fiduciaries when making such a claim should set forth, in connection with their returns, the provisions of law, trust, or decree requiring such depreciation deduction where any exists, or when actual depreciation occurs, the amount thereof, and that the same has been or will be preserved and applied as such. All amounts paid by fiduciaries to beneficiaries of trust estates from income of such trust estates, whether from reserves or otherwise, are held to be distributions of income, and will be treated for income-tax purposes in accordance with the provisions of law and regulations applicable to the income of such beneficiaries.

116. What returns are required from a fiduciary in the United States where the beneficiaries of the trust are non-resident alien individuals?

Where a fiduciary in the United States is the recipient of trust income for which there is but one beneficiary, and that beneficiary a nonresident alien, the fiduciary will be required to make full and complete return on income-tax Form 1040B for this trust income, on behalf of the nonresident alien, and pay any and all tax shown by such return to be due. Where there are two or more beneficiaries, one or all of whom are nonresident aliens, the fiduciary shall render a return on Form 1041 for and in behalf of the trust estate and a personal return on Form 1040B for each nonresident alien beneficiary.

In addition to the forms described above the fiduciary is required to file withholding return, Form 1042, revised, accompanied by certificate 1098, revised.

WITHHOLDING OF TAX.

117. At what rates and from what income is the normal income tax now to be deducted and withheld at the source?

All individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal

property, fiduciaries, employers, and all officers and employees of the United States having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income of any nonresident alien individual, other than income received as dividends from a corporation which is taxable upon its net income, are required to deduct and withhold normal tax at the rate of 8 per cent from such income of nonresident alien individuals.

All individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determined annual or periodical gains, profits, and income of any foreign corporation subject to the income tax and not engaged in trade or business within the United States and not having any office or place of business therein, are required to deduct and withhold normal tax at the rate of 10 per cent from such income of foreign corporations.

When interest upon bonds, mortgages, or deeds of trust or other similar obligations of a corporation which contain a so-called tax-free or no-deduction clause is paid to nonresident alien individuals or to foreign corporations having no office or place of business in the United States, normal tax at the rate of 2 per cent is to be withheld.

The normal income tax is not to be deducted and withheld from any payment of income to an individual citizen or resident of the United States or to a partnership except when derived from interest on a bond, mortgage, or other obligation issued by a domestic or resident corporation which contains a contract or provision by which the obligor agrees to pay any portion of the tax imposed by the Federal income-tax law upon the obligee or to reimburse the obligee for any portion of the tax which the obligor may be required or permitted to pay thereon, or to retain therefrom, under any law of the United States. That is, if interest is paid upon any obligation of a domestic or resident corporation which contains a so-called tax-free or no-deduction clause to a citizen or resident of the United States or to a partnership, normal tax at the rate of 2 per cent is to be withheld, unless personal exemption is claimed in the case of a citizen or resident of the United States, and then only from the amount of income in excess of the exemption claimed.

118. Is a corporation required actually to deduct and withhold the normal income tax from the amounts of interest it pays on bonds which contain a so-called tax-free or no-deduction clause; or may it pay that interest in full and hold itself liable for payment of the tax from its own funds?

The stipulation in the bonds of a corporation whereby the tax which may be assessed against them, or the income therefrom, is guaranteed, is held not to release any party otherwise liable for the tax. The debtor corporation will be held liable for the amount of tax due whether that tax is actually deducted and withheld, or the interest paid in full and responsibility for payment of the tax assumed by the corporation.

119. How may a citizen or resident of the United States secure the benefit of personal exemption to which he is entitled when receiving a payment of interest on bonds containing a so-called tax-free or no-deduction clause?

By attaching to the interest coupons an income-tax exemption certificate, Form 1001, revised. If exemption is not desired, Form 1000, revised, should be used.

RETURN AND PAYMENT OF TAX WITHHELD AT THE SOURCE.

120. How is tax withheld at the source to be returned and paid?

Tax withheld from income other than interest on corporate obligations shall be reported to the Collector of Internal Revenue for your district on income tax Form 1042, revised, accompanied by certificate 1098, revised, covering each item in the return, on or before March 1 of the year next succeeding the year during which the withholding occurred. Tax withheld from interest on corporate obligations shall be reported to the collector on Form 1012, revised, within 20 days after the close of the month during which the withholding occurred, and summary of such monthly returns shall be made to the collector on or before March 1 on Form 1013, revised.

Payment of the amount of tax assessed against a withholding return shall be made to the collector of internal revenue in whose district the withholding agent is located. Such payment is to be made on or before June 15 of the year in which the withholding return is required to be filed.

The time for filing withholding returns for 1918 has been extended by Treasury Decision 2796 to May 15, 1919.

121. What should a withholding return show?

The name and address of the withholding agent, character of income, and the name and address of the recipient, amount of income, exemption claimed, if any, and the amount of tax withheld.

RETURNS OF INFORMATION.

122. From whom are returns of information required?

Section 254 of the revenue act of 1918 provides that every corporation subject to the Federal income tax upon its own income and every personal-service corporation shall, when required by the commissioner, render a correct return, duly verified under oath, of its payments of dividends, stating the name and address of each stockholder, the number of shares owned by him, and the amount of dividends paid to him.

Section 255 of the same act provides that every individual, corporation, or partnership doing business as a broker (210) shall, when required by the commissioner, render a correct return, duly verified under oath, under such rules and regulations as the commissioner, with the approval of the Secretary, may prescribe, showing the names of customers for whom such individual, corporation, or partnership has transacted any business, with such details as to the profits, losses, or other information which the commissioner may require as to each of such customers, as will enable the commissioner to determine whether all income tax due on profits or gains of such customers has been paid.

Under the provisions of section 256 of the same act all individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagees or real or personal property and employers, making payment to another individual, corporation, or partnership, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in sections 254 and 255 of the act) of or at the rate of \$1,000 or more in any taxable year shall render a correct return duly verified under oath.

Under this section returns of information are required, regardless of amounts, in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations and in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by individuals, corporations, or partnerships, undertaking as a matter of business or for profit the collector of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

123. Upon what forms are the returns of information required by section 256 of the act to be rendered, and with whom are such returns to be filed?

Returns of information should be filed on Form 1099 (revised) and should be filed with the Commissioner of Internal Revenue on or before March 15 of each year, accompanied by a letter of transmittal, under oath on Form 1096 (revised).

124. Where a person receives a cash compensation for services rendered, and in addition thereto commissions, living expenses, or other allowances, is the aggregate amount of cash plus the value to such person of the allowance to be returned?

Yes. A return is required in each case where the cash compensation plus the value of the allowances equals or exceeds \$1,000 for the taxable year.

PAYMENT, ABATEMENT, AND REFUND OF TAX ASSESSED.

125. To whom is an assessment of income tax to be paid?

To the collector of internal revenue with whom your return is filed.

126. When does payment of income tax assessed on individuals become due and payable?

The tax is to be paid in four installments, each consisting of one-fourth of the total amount of the tax. If return was made on a calendar year basis, the first installment is to be paid on March 15 of the year following the taxable year, the second installment is to be paid on the 15th day of June of that year, the third installment on the 15th day of September of that year, and the fourth installment on the 15th day of December of that year.

Where an extension of time for filing a return is granted, the time for payment of the first installment is to be postponed until the date of the expiration of the period of the extension, but the time for payment of the other installments is not to be postponed unless the commissioner so provides in granting the extension. However, in any case in which the time for the payment of any installment is, at the

request of the taxpayer, postponed because of an extension of time for filing the return, there is to be added as part of such installment, interest thereon at the rate of one-half of 1 per cent per month from the time it would have been due had no extension been granted until paid. If any installment is not paid when due, the whole amount of the tax unpaid becomes due and payable upon notice and demand by the collector. If any tax remains due and unpaid for 10 days after notice and demand by the collector, or, in the case of the first installment as computed by the taxpayer, remains due and unpaid for 10 days, interest at the rate of 12 per cent per annum from the due date and a penalty of 5 per cent are added, except in certain cases referred to in the regulations.

127. May the income tax due from a taxpayer be paid in a single payment instead of in installments?

Yes. Section 250 of the act provides that the tax may, at the option of the taxpayer, be paid in a single payment, in which case the total amount is to be paid on or before the time fixed by law for filing the return, or, if an extension of time for filing the return has been granted, on or before the expiration of the period of such extension.

128. What recourse has a taxpayer when he feels that he has been assessed with income tax in excess of his true tax liability?

He may exercise his right to file with the collector of internal revenue for his district a claim for abatement executed on Form 47, copies of which may be obtained from the collector. The filing of such a claim prior to the expiration of 10 days from date of notice and demand by the collector acts as a stay to the collection of the 5 per cent penalty for delinquency in payment, provided in case of rejection of the claim the tax due is paid within 10 days from the date of notice of such rejection. However, in case of rejection, interest at the rate of one-half of 1 per cent per month will run from the time the amount was due until the claim is decided.

It should be understood, however, that the filing of a claim for abatement of tax alleged to have been erroneously assessed does not necessarily operate as a suspension of the collection of the tax. If the collector feels that the suspension of collection will jeopardize the interests of the Government, he may collect the tax and leave the taxpayer to his remedy by a claim for refund.

129. On my 1917 return I was assessed with income tax in excess of my true tax liability and same was paid. How may I secure a refund?

By filing with the commissioner a claim for refund, executed on Form 46, copies of which may be obtained from the collector for your district.

130. In 1918 I paid \$50 income tax in excess of my true tax liability for the year 1917. Can this excess payment be applied in payment of a later assessment of tax?

Yes. The excess payment, if claim has been allowed by the Commissioner, is to be credited against any income, war-profits or excess-profits taxes, or installment thereof, due from the taxpayer at the time of the discovery of the overpayment for the prior year, and any balance of such excess is to be refunded to the taxpayer.

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